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SUBJECT: IN DECISIONS ON ENERGY, NEW ZEALAND IS AT A
CROSSROADS

REF: A. WELLINGTON 849

[1](#)B. WELLINGTON 603

[1](#)C. 2004 WELLINGTON 291

(U) Sensitive but unclassified -- please protect accordingly.

Summary

[1](#)1. (SBU) With the days of abundant and cheap electric power over, New Zealand faces critical decisions on how to ensure its energy supplies keep pace with future demand. The task is complicated by years of under-investment, regulatory uncertainties and uneven government policies. New Zealand's obligations under the Kyoto Protocol and its anti-nuclear policy constrain the government's choices. More than a decade after the initial alarms were sounded on a future energy shortfall, no solution is evident. Energy issues were largely ignored during the country's recent election campaign, aside from the Green Party's calls for energy conservation coupled with increased reliance on renewable power sources. With a new Labour-led government in place and electricity prices rising rapidly, the stage is set for serious debate on how New Zealand can secure future energy supplies.

Demand outstripping supply

[1](#)2. (U) New Zealand no longer can look to dam another river to meet electricity demand, which is rising about 2 percent a year. Hydro supplies about 64 percent of the nation's electricity, but there are virtually no more politically acceptable sites available for large hydropower plants. Domestic natural gas, now the second-largest source for electric generation with a 16 percent share, is also tapping out. The Maui gas field, which provides 64 percent of the nation's natural gas, is expected to run dry by 2007. New electric generating capacity is not coming on line fast enough to meet expected load growth and to replace old thermal plants by 2025, according to Brian Leyland, an energy consultant.

Investment hurdles

[1](#)3. (SBU) Years of under-investment in the utility sector -- caused in large part by regulatory delays and uncertainties -- have left New Zealand faced with the prospect of widespread power brown-outs in the event of a single dry year. Government policies and the industry's structure have failed to promote competition and discouraged private investment.

[1](#)4. (U) Much of the uncertainty hanging over needed new power plants comes from the Resource Management Act (RMA) of 1991, which requires local review of major resource uses. Meridian Energy in March 2004 cited uncertainty over obtaining resource consents under the RMA as one reason why it pulled the plug on a planned NZ \$1.2 billion (US \$837 million) hydropower project, which alone would have provided about 8 percent of the country's energy needs. Scrapping what would have been the third-largest hydro plant probably spelled the end to large-scale hydropower projects. The RMA has quashed other energy investment decisions, such as Genesis Energy's plan for a 19-turbine wind farm. A local council objected to the project's potential impact on the visual environment, equestrian events and cultural values of the indigenous Maori. Transpower, the state-owned monopoly that owns and operates the national transmission grid, wants to complete a NZ \$1.5 billion (US \$1 billion) upgrade, but would need separate resource consents from many local councils and dozens of landowners -- a process it claims could take years to complete. Parliament in August 2005 amended the RMA, which may speed up approvals for energy projects.

[1](#)5. (SBU) The sector's public-private ownership structure has stymied competition and failed to stimulate adequate investment in new generating capacity. Five companies, three of which are state-owned enterprises, supply 92 percent of the country's electricity needs. Each of the five is vertically integrated, with a hand in both generating electricity and retailing it to consumers. The supposed rival companies have swapped customer bases to assemble

dominant regional power blocs. That in turn has dissuaded new competitors. Furthermore, the companies see no advantage in building additional generating capacity far ahead of their customers' demand.

16. (SBU) Government policy also has skewed the sector's choices away from its most cost-efficient option: domestic coal. The Labour government, with a tip of the hat to its Green Party allies, wants expanded investment in renewable sources of electricity generation and continues to support New Zealand's participation in the Kyoto Protocol. (The government in June announced that New Zealand would likely miss its emissions allocation target and have to buy carbon credits; ref B.) Yet, New Zealand's largest and most readily available energy source is coal, which now generates 9.7 percent of the country's electricity. Even with the added costs of a NZ \$15-per-ton carbon dioxide tax, coal could be the cheapest source of additional energy.

17. (SBU) By signaling a willingness to fund some new generating capacity, the government risks crowding out private investment. It built and is paying the operating costs of a 155 megawatt oil-fired reserve plant that opened in June 2005. It also has underwritten a new 365 MW gas-fired power station, which is scheduled to go on line in 2006 and is owned by state-owned enterprise Genesis Power. The head of the Electricity Commission, Roy Hemmingway -- formerly chair of the Oregon Public Utility Commission -- criticized the government's guarantee as a possible deterrent to private investment.

The answer is blowing in the wind?

18. (SBU) The Electricity Commission set up shop in late 2003 in hopes of resolving some of the industry's marketing and structural problems. Established to regulate the industry after the companies failed at self-governance, the Commission is charged with ensuring security of supply and reserve generation, investment in the transmission grid, promotion of retail competition and energy conservation. The Commission spent its first two years developing a work program and planning for reserve energy, but has yet to make any tough decisions. Its first major challenge could be deciding how to fund the upgrade of the national grid, which was largely built in the 1950s and has been expanded but never overhauled. A proposal to install new transmission lines to feed power to the country's largest city, Auckland, has aroused fierce resistance from farmers and other landowners.

19. (SBU) New Zealand faces questions with no easy answers on how to secure future electricity supplies. Genesis and Contact Energy are pushing for importation of liquefied natural gas (LNG) if no new gas discoveries are made in the next couple of years. With LNG prices tracking the rise in oil prices, critics say LNG would be expensive and put New Zealand at the mercy of a price-volatile commodity. In addition, the oil and gas industry contends that competition from LNG would deter exploration for domestic gas supplies. Genesis has proposed building three natural gas-fired stations, including the 365 MW gas-fired plant. However, it has put future projects on hold until new domestic gas supplies to replace the Maui field are assured. Mighty River has proposed converting a mothballed power plant to run on coal, but Labour and the Greens are opposed to new carbon-emitting plants. New Zealand's continued reliance on hydropower makes it vulnerable to drought-induced electricity shortages, such as those that occurred during dry spells in 2001 and 2003. A nuclear power option is off the table in a country that takes pride in a "green" reputation and an anti-nuclear policy that has become part of a national identity.

110. (SBU) Almost by default, New Zealand is turning incrementally to wind power. Although costly to build on a unit-cost basis and unlikely to meet all of New Zealand's future demand, it can be added in smaller amounts with smaller price tags than large traditional power plants. Over-reliance on wind would require an expensive backup plant to supply electricity during calm periods. Wind farms also have faced local opposition. Meridian and TrustPower have plans for NZ \$2 billion (US \$1.4 billion) in investment in wind farms totaling 1000 MW of capacity over the next decade. In just one year, to March 2005, wind power's share of New Zealand's electricity generation rose from 0.4 percent to 1.1 percent.

Comment: Firing up public debate

11. (SBU) In contrast to the Labour government's strong commitment to the Kyoto Protocol and promotion of renewable energy, the opposition National Party has said it would consider increased use of coal to meet the country's energy needs. National wants to review New Zealand's participation in the Protocol and opposes Labour's carbon tax. The government faces increasing complaints over electric power prices. Traditionally low by first-world standards and

steady because of New Zealand's large stake in hydroelectricity, electricity prices jumped in a range of 7.6 to 10.4 percent during the year ended June 2004. Recent price hikes raised the cost of electricity an additional 8.1 to 10.1 percent in 2005.

12. (SBU) A consensus has not yet emerged on how New Zealand will feed its growing appetite for electricity. No one type of generation has won an edge as cost-effective, sustainable or politically popular. It is clear, however, that New Zealand will rely in the future on more varied and costly sources of electric power.
Burnett